

# Impact of Dividend Policy on Share Holders' Wealth

## A Study of Listed Companies in Hotels and Travels Sector of Sri Lanka

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**Abstract**— this research intends to study the impact of firm's dividend policy on shareholders' wealth. The objective of the company is to increase the wealth of its shareholders. It is therefore necessary, to understand the nature of the relationship between dividend and shareholders' wealth. Tourism remains the fastest growing service industry in the economies of most of developing countries. Sri Lanka entered the international tourism market in the 1960s. Since then, Hotel and Travel sector has been growing steadily as a promising sector. In particular, the contribution of Hotel and Travel sector to Gross Domestic Product was 2% in Sri Lankan economy. In attempt to fill this research gap the present study was initiated to find out the impact of dividend policy on shareholders' wealth of top ten listed companies under hotel and travel sector in Sri Lanka during the period from 2008 to 2012. Secondary data is collected from company annual report. This research used the correlation, regression and descriptive statistics to evaluate the data collected from the top ten listed companies under hotel and travel sector. In addition the dividend policy has significant impact on shareholders' wealth. There are Positive relationship between Return on Equity, dividend per share and Dividend payout ratio and Shareholders' wealth of top ten listed companies under hotel and travel sector in Sri Lanka and mean while there is a negative relationship between retention ratio and Shareholders' wealth.

**Keywords**- Colombo Stock Exchange; Dividend Policy; Hotel and Travel Sector; Shareholders' wealth.

### I. INTRODUCTION

The objective of the finance manager should be to find out an optimal dividend policy that will enhance value of the firm. To add the value to the companies, today's finance managers have to make critical business and financial decisions which will lead to long-run perspective with the objective of maximizing the shareholders' wealth.

This research intends to study the impact of firm's dividend policy on shareholders' wealth. Primary objective of this research is to analysis the impact of dividend policy on share holders' wealth. It is therefore necessary, to understand the nature of the relationship between dividend and shareholders' wealth.

Tourism remains the fastest growing service industry in Sri Lanka. Hotel and Travel sector has been growing steadily as a promising sector. The implication of this study is more significant for the hotels and travel sector in Sri Lanka.

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The implication of this study is more significant for the hotels and travel sector in Sri Lanka. Because, The Hotels and Travel sector represents the major part of Sri Lankan's economy. As no significant study has been conducted yet on dividend policy and shareholders' wealth in Sri Lanka, there is an emerging need to conduct this study.

### II. REVIEW OF LITERATURE

Is the value of shareholder's wealth affected by the dividend policy of the firm? This is the main question of this research. Some empirical studies appear to support this research paper which are discussed below,

The investment, financing and dividend decisions are interdependent and must be resolved simultaneously. A combination of these policy decisions should theoretically maximize shareholders' wealth Botha (1985:3). The dividend payment pattern of a firm is influenced by the current year earnings and previous year dividends. Lintner (1956). Lintner and Gordon pioneers of the dividend relevance theory argued that shareholders prefer dividends to capital gains. Gitman (1997:574). Study on American stock markets (S&P500) that higher aggregate dividend payout ratios were associated with higher future earnings growth. Arnott and Asness. (2003). Both Zhou and Ruland (2006) and Gwilym (2006) supported the findings of Arnot and Asness.

The possible impact of dividend payouts on future earnings growth Zhou and Ruland (2003). Corporate managers typically believe that dividend policy affects a firm's value and that an optimal level of dividend payout exists. Farrelly, Baker, and Edelman (1985). In a survey on dividend policy, most respondents think dividend policy affects firm value and also it has effect on shareholder's wealth Baker and Powell (1999).

Increasing the percentage of cash dividends would increase a company's value, thus increasing the shareholders' wealth. Gordon (1959), Blume (1980), Dyl and Weigand (1998), Koch and Shenoy (1999). The firm can enhance its business value by providing for a more generous dividend policy as investors seem to prefer dividends over capital gains. JM Samuels, FM.Wilkes and R.E Brayshaw Benartzi (1997).

Baker and Powell (1999) had a survey on dividend policy they found that firm value and wealth of shareholder is affected by dividend policy. Most respondents think dividend policy

affects firm value and also it has effect on shareholder's wealth Baker and Powell (1999).

If a firm retains and reinvests income rather than paying dividends, those shareholders who need current income would be disadvantaged. Brigham et al (2004:512). Shareholders' wealth is not influenced by current and future dividend decisions, but depends entirely on the earning power of the firm's assets. Botha (1985:48)

There is no any impact on the shareholders wealth when the announcement of a dividend made. Merton Miller and Franco Modigliani (1961). Increasing the percentage of cash dividend will lead to a decline in the value of a company, thereby reducing the wealth of shareholders Litzenberger and Ramaswamy(1979), Blume(1980), Litzenberger and Ramaswamy (1982), Ang and Peterson(1985).

Cash dividends lead to a decrease in the company's value and reduce the owner's wealth Brennan (1970). The dividend payout decision does affect the shareholders value De Angelo and De Angelo (2006). Free cash flow (dividend) causes conflict between management and shareholders Frankfurter et al (2002:7). Dividends may curb managers from investing in projects that do not benefit shareholder wealth. Lease et al (2000:87).

### III. SIGNIFICANCE OF THE STUDY

In Sri Lanka, the industry do not follows the same patterns as in other countries because of terrorism and other political and economic issues make the investor hesitate to invest. The Hotels and Travel sector being the major sector of Sri Lankan's economy.

The implication of this study is more significant as the listed companies of the hotels and travel sector in Sri Lanka. Because, The Hotels and Travel sector represents the major part of Sri Lankan's economy. The greatest amount of research has been devoted to the effect of dividend policy on shareholders wealth'. There is a preponderance of evidence that dividends play an important role in capital market. Dividend decisions are recognized as centrally important because of increasingly significant role of the finances in the firm's overall growth strategy.

Shareholders wealth is represented in the earning per share, which, in turn, is the function of the company's investment, financing and dividend decisions. Among the most crucial decisions to be taken for efficient performance and attainment of objectives in any organization are the decisions relating to dividend.

The objective of the finance manager should be to find out an optimal dividend policy that will enhance value of the firm. It is often argued that the share prices of a firm tend to be reduced whenever there is a reduction in the dividend payments With the view of examining whether the dividend policy is impact on shareholders wealth' in Sri Lankan stock market However, the impact of firm's dividend policy on shareholders wealth is still unresolved. It is therefore a matter of concern that dividend policy issues experience shareholders' wealth of the firms in Sri Lanka. This research tries to unfold the relationship between the shareholders wealth and the dividend policy and analyses whether the dividend policy affects the wealth of the shareholders.

After nearly three decades of operating in an extremely challenging environment amid the military conflict, the outlook on the industry has now completely turned around. it is expected to play a wider role in Sri Lanka's future economic development. According to the Central Bank of Sri Lanka, the hotel industry only contributes around 2% to the country's gross domestic product at the moment.

TABLE I. OPERATIONALIZATION

Concept	Variables	Formula
Independent Variables	Return on equity	Net Profit / Shareholders' equity
	Dividend Policy	DPS / EPS
	Dividend payout ratio	Dividend / No of shares
	Retention Ratio	1 - Dividend payout
Dependent Variable	Earnings Per Share	Earnings / Total No of Shares

To date, most studies have paid attention on influence of cash flows or earnings on the dividend payment of a firm. Further, for the dividend policy makers of the Sri Lankan Hotel and Travel sector, the study may prove to be useful for re-sketching their dividend policy keeping in view the analysis, results and discussions presented. Through the research one can have better understanding of the factors that should systematically affect firms' payout decisions. It also gives insight into what kind of ownership structure is beneficial for the shareholders.

As no significant study has been conducted yet on dividend policy and shareholders' wealth in Sri Lanka, there is an emerging need to conduct this study and especially to deal with the unresolved issues of dividend policy and shareholders' wealth.

However, this research will sufficiently be able to solve the research problems raised for Share markets on dividend policy and shareholders' wealth. This study arises to be the benchmark of the empirical studies on dividend policy and shareholders' wealth. Moreover, this study will draw attention to the portfolio investors, security analysts, policy-making bodies, and especially regulatory bodies of the share markets. This research will obviously provide a clear guideline to the parties associated in the market and especially to the outsider investors and to the regulatory bodies. Finally, after the war, it could be concluded that, 'it is the right attempt at the right time'.

### IV. OBJECTIVES AND HYPOTHESES

Primary objective of the research is to analysis the impact of dividend policy on share holders' wealth. From this research, the researcher is able to find out the following research question.

- Is there any relationship between dividend policy and shareholders' wealth of Top ten companies listed under hotels and travel Sector?

- Whether dividend policy have significant impact on the shareholders wealth' of Top ten companies listed under hotels and travel Sector?

Based on previous studies the researcher establishes the following hypotheses with the intention to solve the research problem.

H<sub>1</sub>: There is a positive relationship between ROE and Shareholders' Wealth

H<sub>2</sub>: There is a positive relationship between Dividend payout Ratio and Shareholders' Wealth.

H<sub>3</sub>: There is a Positive relationship between Dividend per share and Shareholders' Wealth

H<sub>4</sub>: There is a Negative relationship between Retention Ratio and Shareholders' Wealth.

## V. RESEARCH METHODOLOGY

This research utilizes the data of the listed companies of the hotels and travel sector in Sri Lanka. Cluster sampling techniques would be used. This research uses secondary data of selected Companies. Researcher is focused on top ten companies which are listed by LMD magazine. Data collection was analyzed using computer based statistical data analysis package such as SPSS - Version 16.0 and Excel. Regression and correlation analysis were used for this study.

## VI. RESULT AND DISCUSSION

H<sub>1</sub>: There is a positive relationship between ROE and shareholders' wealth

The value of Correlation between return on equity and shareholders' wealth represents the strong positive relationship between Return on Equity and Shareholders' wealth. So, this hypothesis (H1) is accepted.

H<sub>2</sub>: There is a positive relationship between dividend payout ratio and shareholders' wealth.

The value of correlation between dividend payout ratio and shareholders' wealth represents the average positive relationship between dividend payout ratio and shareholders' wealth. So, this hypothesis (H2) is accepted.

H<sub>3</sub>: There is a positive relationship between dividend per share and shareholders' wealth.

The value of correlation between dividend per share and shareholders' wealth represents the strong positive relationship. Therefore, when dividend policy variables like Return on Equity, Payout ratio, dividend per share increase, Shareholders' wealth for top ten companies under hotels and travel sector will increase. So, this hypothesis (H3) is accepted.

H<sub>4</sub>: There is a Negative relationship between Retention Ratio and Shareholders' Wealth.

The value of correlation between retention ratio and shareholders' wealth shows the average negative relationship between retention ratio and Shareholders' wealth. Therefore, when retention ratio increases, Shareholders' wealth will decrease. This hypothesis (H4) is also accepted.

TABLE II. CORRELATIONS

		ROE	PAYOUT	RETENTION	DPS	EPS
ROE	Pearson Correlation	1				
	Sig. (2-tailed)					
	N	50				
PAYOUT	Pearson Correlation	.325*	1			
	Sig. (2-tailed)	.021				
	N	50	50			
RETENTI	Pearson Correlation	-.325*	-1.000**	1		
	Sig. (2-tailed)	.021	.000			
	N	50	50	50		
DPS	Pearson Correlation	.532**	.819**	-.819**	1	
	Sig. (2-tailed)	.000	.000	.000		
	N	50	50	50	50	
EPS	Pearson Correlation	.628**	.403**	-.403**	.574**	1
	Sig. (2-tailed)	.000	.004	.004	.000	
	N	50	50	50	50	50
**. Correlation is significant at the 0.01 level (2-tailed).						

TABLE III. COEFFICIENTS OF OVERALL DEPENDENT AND INDEPENDENT VARIABLES

	Model	Un standardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.535	.222		2.408	.020
	RETURN ON EQUITY	.118	.034	.442	3.411	.001
	PAYOUT RATIO	-.005	.016	-.055	-.288	.775
	DIVIDEND PER SHARE	1.096	.609	.384	1.799	.079
R Square : R <sup>2</sup>						0.476
a. Dependent Variable: EPS (Source: SPSS output)						

From the above table, it is observable that the dividend policy variables that have been selected for this research have 47.6% impact on shareholders' wealth (EPS). Another 52.4 % is influenced by other determinants of Shareholders' wealth.

TABLE IV. COEFFICIENTS OF ROE AND SHAREHOLDERS' WEALTH

Model	Un standardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	.660	.215		3.076	.003
ROE	.167	.030	.628	5.592	.000
R Square : R <sup>2</sup>					.395

a. Dependent Variable: EPS  
(Source : SPSS output)

The above table indicates that the co-efficient of determination is 0.395. That is only 39.5% of variance in the shareholders' wealth (EPS) is accounted by the return on equity. Another 60.5 % is influenced by other determinants of Shareholders' wealth. The regression equation  $Y = 0.660 + 0.167x$  exhibits that the relationship between dividend policy and shareholders' wealth. If dividend policy is  $X=0$ , shareholders' wealth is to be 0.660. Further dividend policy is increased by one; the shareholders' wealth will be increased by 0.167. Therefore, it can be said that there is a positive relationship between variables.

TABLE V. COEFFICIENTS OF PAYOUT RATIO AND SHAREHOLDERS' WEALTH

Model	Un standardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	.791	.263		3.007	.004
PAYOUT	.035	.011	.403	3.053	.004
R Square : R <sup>2</sup>					.163

a. Dependent Variable: EPS  
(Source : SPSS output)

The above table indicates that there is positive relationship between dividend payout ratio and 16.3% interact with dependent variable. Another 83.7 % is influenced by other determinants of Shareholders' wealth. The regression equation  $Y = 0.791 + 0.035x$  exhibits that the relationship between dividend policy and shareholders' wealth. If dividend policy is  $X=0$ , shareholders' wealth is to be 0.791. Further dividend policy is increased by one; the shareholders' wealth will be increased by 0.035. Therefore, it can be said that there is a positive relationship between this variables.

TABLE VI. COEFFICIENTS OF DPS AND SHAREHOLDERS' WEALTH

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	.692	.227		3.044	.004
DPS	1.638	.337	.574	4.856	.000
R Square : R <sup>2</sup>					.329

a. Dependent Variable: EPS  
(Source : SPSS output)

The above table indicates 32.9% of dividend per share influences the shareholder's fund. Another 67.1 % is influenced by other determinants of shareholders' wealth. The regression equation  $Y = 0.692 + 1.638x$  exhibits that the relationship between dividend policy and shareholders' wealth. If dividend policy is  $X=0$ , shareholders' wealth is to be 0.692. Further dividend policy is increased by one; the shareholders' wealth will be increased by 1.638. Therefore, it can be said that there is a positive relationship between variables.

TABLE VII. COEFFICIENTS OF RETENTION RATIO AND SHAREHOLDERS' WEALTH

Model	Un standardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	4.262	1.026		4.155	.000
RETENTION	-.035	.011	-.403	-3.053	.004
R Square : R <sup>2</sup>					.163

Dependent Variable: EPS  
(Source : SPSS output)

Table 7 indicates the coefficient of determination is 0.163. It means that 16.3% of variability of retention ratio can be accounted. For by its negative liner relationship with shareholders' wealth it follows that 83.7% of variability of retention ratio is not explained by the shareholders' wealth.

The regression equation  $Y = 4.262 + -0.035x$  exhibits that the relationship between dividend policy and shareholders' wealth. If dividend policy is  $X=0$ , shareholders' wealth is to be 4.262. Further dividend policy is increased by one; the shareholders' wealth will be decreased by 0.035. Therefore, it can be said that there is a negative relationship between this variables. Therefore, this research implies that dividend policy has a significant impact on shareholders' wealth.

## VII. CONCLUSION

According to this study, the researcher concluded that there is a significant impact of dividend policy on shareholders' wealth. Return on equity, dividend payout ratio and dividend per share are positively correlated with shareholders' wealth, But, retention ratio is negatively correlated. So, maintaining optimum use of dividend policy is essential.

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